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E.O. 12958: DECL: 08/27/2018
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SUBJECT: ENGAGING THE GOVERNMENT OF PAKISTAN ON ITS ECONOMIC SITUATION

Ref: Islamabad 2812 and previous

Classified By: SCA Acting Assistant Secretary Donald Camp for reasons 1.4 (b) and (d).

¶1. (SBU) This is an action request; see para 4.

¶2. (C) Despite the difficult political context, the precarious economic situation in Pakistan necessitates that we continue to press senior GOP leadership on the urgent need for additional steps to restore confidence and avert an economic crisis. Prime Minister Gilani has told Ambassador Patterson that significant action along the lines proposed by Deputy Treasury Secretary Kimmitt to Finance Minister Qamar will be difficult, if not impossible, to implement in the short term. Initial policy actions, including reductions in fuel subsidies and increases in interest rates, have already placed a strain on the government. The decision-makers within the government, however, may not be fully aware of the imminence of the crisis, or, if they are, are choosing to hedge their bets in hope that the situation improves, or that they will be bailed out by the international community.

¶3. (C) Accordingly, we need to reiterate to Pakistan's senior leadership, particularly the PPP leadership and Presidential candidate Zardari: 1) the likelihood, scope and implications of the looming economic crisis; 2) the need to take decisive actions now to avert an otherwise imminent economic crisis; and 3) that emergency external assistance (U.S., Saudi, World Bank) is uncertain, if not unlikely, unless also accompanied by significant fiscal and monetary reforms.

¶4. (C) Washington agencies understand that GOP action prior to the election of a new President is highly unlikely. Once elected, however, a new President as one of his first public pronouncements could make a statement on the need for bold actions now to avoid greater hardship in the future. Below are suggested talking points for Ambassador to use in discussions with Mr. Zardari and his senior advisors, as deemed appropriate,

¶5. (C - releasable to GOP)

-- A newly-elected President could take the opportunity to announce dramatic actions that are required to avoid even worse hardship for the Pakistani people. This is a chance for the new President to demonstrate strong leadership aimed at resolving the problems the Pakistani Government inherited.

-- The Government's efforts to date - reducing some fuel subsidies, raising interest rates - are welcome but have failed to restore confidence and stop the reserve losses. Reserves were only \$6.26 billion as of August 15, a loss of \$600 million in two weeks. We anticipate that the GOP will soon be unable to pay its bills, by October or sooner, if foreign exchange reserves continue to decrease at this rate.

-- External financial assistance alone will not solve the problem, and budget support would only briefly delay the onset of a crisis. Absent swift and credible policy actions by your government, external assistance will dissipate quickly, Pakistan will still face a crisis and donors will be very hesitant to

provide additional financial support.

-- Pakistan's leaders need to demonstrate their capacity to confront the economic crisis directly. We urge the newly-elected President to make a clear public statement of GOP economic policy soon after election, outlining an adjustment plan and accompanied by immediate actions aimed at restoring confidence of domestic and foreign investors. The GOP needs to

- 1) cut fuel subsidies again in the short-term and eliminate them by the end of the 2008 calendar year;
- 2) cease borrowing from the central bank, and resume market borrowing to fund the budget deficit; and
- 3) resume and accelerate privatization.

-- Negotiating an IMF program would be an effective step in restoring investor confidence. Working with the IMF on a Pakistani-designed program that has meaningful conditionality would be a particularly welcome sign to investors and financial markets. If the GOP chooses not to seek an IMF program, then policy actions must be even bolder in order to establish credibility and restore investor confidence, and we encourage continued active engagement with the IMF in any event.

-- Immediate actions are critical to avoid a crisis. We are willing to use USG influence to support these efforts by working with bilateral and multilateral donors, but only if the GOP undertakes a credible adjustment program (i.e., actually has undertaken these steps and has established measures of accountability).

-- We recognize that it will be difficult to announce and implement some of these steps in the current political context, but these steps must be taken, and quickly. In conclusion we urge the GOP to forge ahead with its program of fiscal and monetary reforms as quickly as possible, noting that with each passing day the risk of a deeply painful and politically destabilizing balance of payments crisis grows.

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